Nos. 10589, 10590, 10591, 10592

In the United States Circuit Court of Appeals for the Ninth Circuit

New Idria Quicksilver Mining Company, a Corporation, petitioner

v.

Commissioner of Internal Revenue, respondent

Klau Mine, Inc., a Corporation, petitioner

v.

Commissioner of Internal Revenue, respondent

Oat Hill Mine, Inc., a Corporation, petitioner

v.

Commissioner of Internal Revenue, respondent

Wild Horse Quicksilver Mining Co., a Corporation, petitioner

v.

Commissioner of Internal Revenue, respondent

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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CITATIONS

JURISDICTION

Each of these four appeals involves federal income taxes. On June 30, 1942, the Commissioner of Internal Revenue mailed to the New Idria Quicksilver Mining Company a notice of deficiency for the tax years 1939, 1940 and 1941. Within ninety days thereafter and on September 8, 1942, New Idria Quicksilver Mining Company filed its petition for review with the Board of Tax Appeals (now the Tax Court of the United States) for a review of that determination under the provisions of Section 272 of the Internal Revenue Code. (R. 3–22.) The printed record before this Court does not show the date of the mailing of the notice of deficiency or the date when the petition was filed with the Board in any of the other three cases, but in each of those cases the respective dates were the same as the corresponding date in the New Idria Quicksilver Mining Company case. The case of each of the other three taxpayers, however, involved only that taxpayer's taxable year 1940. The Tax Court entered a separate final order in each case on August 13, 1943. (R. 110–113.) The cases are brought to this Court by separate petitions for review, each filed October 12, 1943, pursuant to the provisions of Sections 1141–1142 of the Internal Revenue Code. (R. 114–119.) By order of this Court dated November 5, 1943, entered upon stipulation of the parties, the several cases were consolidated in this Court for purposes of review. (R. 126–130.)

QUESTIONS PRESENTED

1. Whether in the case of quicksilver mines percentage depletion is computed on the market value of the cinnabar ore as it emerges from the mine or on the gross sales of the liquid mercury which the mining company processes from the mined ore.

2. Whether any depletion deductions are allowable to the New Idria Quicksilver Mining Company in respect to the cinnabar ores or in respect to the mercury the New Idria company extracted from cinnabar ores deposited and dumped upon its land by the previous owners of that land.

3. Whether the Oat Hill Mine, Inc., may take a deduction from income for the $3,750 it paid to an electric company during the tax year 1940 for an extension of a power line to the Oat Hill mine.

STATUTES AND REGULATIONS INVOLVED

These will be found in the Appendix, *infra*.

STATEMENT

Many of the facts were stipulated before the Tax Court (R. 28–54, 55–56, 56–60, 61–62) and the stipulated facts were then supplemented by the testimony of three witnesses for the several taxpayers (R. 64–87). One issue is common to all four cases; another issue is involved only in the case of the New Idria Quicksilver Mining Company, a Nevada corporation organized July 3, 1936 (R. 28); and a further issue is peculiar to the Oat Hill Mine, Ins., case. All four taxpayers were corporations, but two of them, Oat Hill Mine, Inc., and Wild Horse Quicksilver Mining

Company, were dissolved in December, 1941, that is, approximately a year or more after their tax year here involved. Upon dissolution the directors of the two dissolved corporations became trustees for the corporate creditors and stockholders. All the taxpayers, save Oat Hill Mine, Inc., owned the mines which they operated; Oat Hill operated under a sublease. All four corporations made their income and declared value excess profits tax returns upon the accrual basis. (R. 91–92, 96.)

The further facts as found by the Board were as follows: [1]

Quicksilver, or mercury, is obtained from ore containing cinnabar, a chemical compound of mercuric sulphide. In order to secure most efficient production the cinnabar ore is crushed and roasted in ovens and the mercury is released in the form of a vapor. The vaporized mercury is then condensed and worked with lime to remove soot and other impurities. After this cleaning operation the mercury is placed in metal containers or "flasks" and sold on the market. (R. 92.)

New Idria's principal source of mercury during the taxable years was crude cinnabar ore extracted from subterranean workings in its mine. These workings were developed by "drifts" and "crosscuts." The ores were blasted and sorted in the mine and those containing sufficient cinnabar were hauled in cars to the

[1] The witnesses with respect to depletion all testified specifically as to the situation of the New Idria Company after a stipulation of counsel (R. 63–64) that the record made on the one issue in the New Idria case would be considered a part of the record in each of the three other cases.

surface where they were crushed and carried by conveyors to the furnaces. (R. 92.)

New Idria operates two furnaces at its mine. They are of the rotary type, five feet in diameter and fifty-six feet in length. They are made of iron and lined with fire brick. The crushed ores are fed into the furnaces and heated to a temperature of about 1,200° Fahrenheit. The mercury vapors as they are released by the heat are drawn from the furnace by suction fans and passed into a condenser system, which consists of two vertical banks of ten pieces of sixteen-inch iron pipe each, with rubber buckets at the bottom of the pipes to collect the condensed mercury. These buckets are emptied on tables where the contents are mixed with slack lime and worked with hoes to cleanse or free the mercury. After this operation the mercury is practically pure and is ready for market. (R. 92–93.)

This method of extracting mercury is similar in many respects to the method used in extracting gold by the "amalgamation" process. By that process concentrated gold ore is treated with mercury, causing a fusion or amalgamation of the gold and mercury, which are said to have a natural affinity for each other, and the mercury is then separated from the gold by distillation. (R. 93.)

Experiments have been made from time to time in prior years, by New Idria and others, with different methods, such as the "gravity" and "flotation" methods, for concentrating the cinnabar ore before furnacing and condensing it. These experiments have all proved uneconomical. The cost of concentration alone was found to be approximately as great as or greater than the cost of roasting the crude ore in the rotary furnaces, and the concentrated ore still had to be heated in retorts. At the present time the method employed by New Idria, as described above, is that generally used in the production of mercury, commercially, in the United States. (R. 93–94.)

The Tax Court also found that after concentrating cinnabar ore by either the uneconomical gravity or the uneconomical flotation methods the additional processes of furnacing, condensing, cleaning and flasking were still necessary. (R. 100.) As an ultimate finding upon the first issue, the Tax Court found that the processes—which the taxpayers effected—of furnacing the crushed cinnabar ore [2] and condensing, cleaning and flasking the ultimate product, liquid mercury, all "beneficiated the product in a greater degree than 'crushing' and 'concentrating'" the cinnabar by the gravity or the flotation method. (R. 100–101.)[3]

Located on New Idria's properties are large deposits of ores which in years past have been mined and discarded by former operators. Some of these ores have been furnaced by former operators and some

[2] In order to "furnace" the cinnabar ore it was crushed at the mine to a size of not more than two inches. (R. 100.)

[3] Cf. R. 81, where the vice president and general manager of New Idria testified that where flotation or gravity concentration has occurred the ultimate recovery (after all processing) may be 60 to 80 per cent, whereas by quicksilver roasting, condensing and cleaning New Idria recovers about 98½ or 99 per cent.

discarded before furnacing because of their low content of cinnabar ore. Mine operations have been conducted on the property continually since about 1858. The discarded and the burnt ores, which are referred to in the stipulation as "dump" ores, contain a small amount of cinnabar from which mercury can be profitably recovered under modern improved methods of operation. New Idria processed considerable quantities of these dump ores during the taxable years, in addition to the crude ore which it extracted from its mine. They were loaded on trucks with steam shovels and hauled to the furnaces where they were processed in the same manner as the crude ore from the mines. The dump ore deposits are located about a mile and a half from New Idria's plant. (R. 94.)

New Idria's gross sales of mercury obtained from the mined ores and from dump ores during each of the taxable years and its net sales, after deductions of all costs of production but without any deduction for depletion, were as follows (R. 95):

Year	Mined ores		Dump ores	
	Gross sales	Net sales	Gross sales	Net sales
1939	$265, 174. 54	$19, 423. 27	$57, 844. 18	[1] $683. 06
1940	517, 113. 14	160, 982. 65	80, 700. 36	30, 993. 42
1941	791, 227. 75	201, 995. 76	110, 489. 70	40, 313. 66

[1] Loss.

Crude cinnabar ore was not bought or sold in the vicinity of the mines of any of the taxpayers during any of the taxable years and there has never been any established market for it. (R. 95.)

New Idria elected to claim depletion deductions in its income and declared value excess profits tax returns for the taxable years 1939, 1940, and 1941 on a percentage basis, computed on its total gross sales of mercury from all sources. The Commissioner determined in his deficiency notice that New Idria's percentage depletion deductions should be computed on the basis of the selling price, or market value, of the cinnabar ore at the mouth of the mine and not on the selling price of the mercury in flasks. He arrived at that basis by excluding from gross sales, on which the depletion deductions were computed, all of the costs of transporting, furnacing, condensing, cleaning, and flasking, as shown by New Idria's books.[4] The resulting reduction of the depletion allowances claimed in New Idria's returns for each of the taxable years was as follows (R. 95):

Year ended	Claimed in returns	Allowed in deficiency notice
June 30, 1939	$9,009.03	$7,663.81
June 30, 1940	89,672.03	71,202.36
June 30, 1941	122,176.80	94,924.71

The Commissioner filed an amended answer (R. 23–28) in the New Idria case in which he alleged that all of the depletion allowances claimed by New Idria in respect of the "dump" ores should be disallowed and that the deficiencies as determined in the deficiency notice should be increased accordingly. As so in-

[4] The Commissioner used the same method in determining the depletion deductions of each of the other taxpayers.

creased the deficiencies amount to $226.05 for 1939, $5,133.10 for 1940, and $9,879.94 for 1941. (R. 96.)

It was stipulated that the deposits of dump ores on New Idria's properties and all rights in them have been at all times an unsevered part of the realty on which New Idria's mine is located and that the portions of such deposits processed by New Idria during the taxable years were placed thereon prior to March 1, 1913, and so have never been subjected to any depletion allowances in any returns filed by New Idria or prior owners of the property. (R. 96, cf. R. 32–34).

In determining the deficiency against Oat Hill Mine, Inc., the Commissioner disallowed the deduction of an item of $3,750 which that company paid in 1940 to the Pacific Gas & Electric Company for the extension of an electric line and the installation of transformers necessary to furnish electric current to its mine. (R. 96–97.) The payment was made under a contract (R. 58–60) which provided that all of the equipment so used should remain the property of the electric company and that (R. 97):

> If and whenever Applicant shall have operated the electrical apparatus originally installed by him or its equivalent, served from the equipment installed hereunder, for a period of thirty-six (36) consecutive months, and the Applicant's business shall at that time have proved its permanency to the entire satisfaction of the Company, and upon the execution of the proper agreements and the compliance by Applicant with all the conditions necessary to obtain permanent service pursuant to the Company's standard practice relative to the construction

> of electric line extensions in force at the end of said thirty-six months period, the Company *shall repay* to Applicant said contract price except such portion thereof as may be required as a line extension deposit under the Company's standard practice relative thereto, and said deposit shall thereafter be refunded in accordance therewith. [Italics ours.]

The Tax Court held: (1) That taxpayers were not entitled to take percentage depletion upon the gross sales which they made of liquid mercury, the product of processing their cinnabar ore, but only upon the unprocessed value of the cinnabar ore as it emerged crushed and sorted from the mines (R. 104); (2) that no depletion deductions were allowable to the New Idria Quicksilver Mining Company in respect to the cinnabar ore, or the mercury it processed from cinnabar ore, which had been mined by New Idria's predecessors in title and deposited and dumped upon the mining property (R. 106); and (3) that Oat Hill Mine, Inc., was not entitled to deduct from its year 1940 income either all or one-third of the $3,750 it paid that year to Pacific Gas & Electric Company, or deposited with that company, to secure the extension of a power line to the Oat Hill mine (R. 109).

SUMMARY OF ARGUMENT

Percentage depletion, whether in the case of oil and gas wells or in the case of mineral mines, is allowed upon a taxpayer's "gross income from the property" during the tax year, and has been so allowed since the statutory provision for percentage depletion was written into the law. Percentage depletion was allowed in the interest of convenience, but, as with cost or discovery depletion, its fundamental purpose was always that of a compensatory allowance to owners of an economic interest in oil, gas or minerals in place on account of the severance *of their natural resources.* The term "gross income from the property" can only mean the sale price realized for *the crude mineral product,* for only a crude mineral resource is depleted when ore (or crude oil) is brought to the earth's surface.

If extracted ores cannot be sold in their crude state, when brought out of the mine, but must be treated and processed, as is necessary with cinnabar ore in order to produce commercially marketable liquid mercury, the further processes necessary to refine and treat the ore are not mining operations and do not deplete the ore deposit. Such processes are essentially manufacturing processes. Moreover, the profit at which the mine operator-processor sells his ultimate product is *an over-all profit,* the result of the sum of his mining, further processing, refining and manufacturing operations, including in some instances transportation.

As the statutory depletion allowance in the case of mineral mines is 15 per cent of "gross income from the property" being depleted, i. e., of gross income from *the crude ore,* this excludes a deduction of gross income *from other sources.* Thus gross income from refining, manufacturing and non-mining operations is not subject to a depletion allowance.

The Treasury Regulations carry out the statutory purpose, for they plainly state that mine operatorprocessors may not claim a depletion deduction upon either their gross income from non-excepted processing, refining or manufacturing of extracted minerals or upon their net profits from such sources. Such Regulations are valid; the several taxpayers, who manufactured marketable liquid mercury from their crude cinnabar ore, come within them; and the Tax Court properly held that the depletion deduction of each taxpayer must be determined in accordance with the rule elaborated in the Regulations.

The dump material which the New Idria Quicksilver Mining Company alone processed to get liquid mercury was not a part of any mine when New Idria bought it or thereafter. New Idria's entire activities with respect to such dump material seem to be that of a mere processor, who, of course, has no depletable interest and is not entitled to a deduction for depletion. In any event, in furnacing, refining and otherwise treating the dump material to get liquid mercury from it New Idria was manufacturing, not mining, and its gross income from such operations was not subject to a deduction for depletion.

The sum which Oat Hill Mine, Inc., paid an electric company for an extension of a power line was not an expense, either in part or in whole, of Oat Hill's tax year 1940. The $3,750 was refundable under certain conditions and presumably has been refunded ere this. However, if never refunded it was a capital investment to induce service for "an indefinite period" and thus no part of the payment may be taken as a deduction in the year 1940.

ARGUMENT

I

The Tax Court properly held that the percentage depletion allowable in respect to quicksilver mines is computed on the value of the ore as it emerges from the mine

Although all Revenue Acts, beginning at least with that of 1916, allowed the deduction of "a reasonable allowance" for the depletion of mines and of other specified wasting natural resources, under rules and regulations to be prescribed by the Treasury Department,[5] the first Revenue Act to authorize the deduction of "percentage depletion", so-called, in the case of metal, coal and sulphur mines was the Revenue Act of 1932, c. 209, 47 Stat. 169, Section 114 (b) (4) thereof. Percentage depletion had first been allowed in the case of oil and gas wells by the Revenue Act of 1926, c. 27, 44 Stat. 9, Section 204 (c) (2). See, also, Section 114 (b) (3), Revenue Act of 1928, c. 852, 45 Stat. 791. The provision in the 1932 Revenue Act, Section 114 (b) (4), represented an extension by Congress of that with which it was already familiar, i. e., percentage depletion, for oil and gas wells, to the further field of metal mines. As the report of the Senate Committee on Finance put it (S. Rep. No. 665,

[5] See Section 5, Eighth, Revenue Act of 1916, c. 463, 39 Stat. 756; Sections 214 (a) (10) and 234 (a) (9), Revenue Acts of 1918, c. 18, 40 Stat. 1057, and 1921, c. 136, 42 Stat. 227; Sections 214 (a) (9) and 234 (a) (8), Revenue Acts of 1924, c. 234, 43 Stat. 253, and 1926, c. 27, 44 Stat. 9; Section 23 (l), Revenue Act of 1928, c. 852, 45 Stat. 791; and 23 (m) of succeeding Revenue Acts, including the Internal Revenue Code. Cf. Section II, B and G (b), Income Tax Act of 1913, c. 16, 38 Stat. 114, 166.

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72d Cong., 1st Sess., p. 16 (1939–1 Cum. Bull. (Part 2) 496, 508)):[6] "* * * percentage depletion has been extended to metal mines as well as to sulphur and oil and gas wells."

The statutory basis for percentage depletion in the case of oil and gas wells was from the first "the gross income from the property" during the taxable year. Section 204 (c) (2), Revenue Act of 1926; Section 114 (b) (3), Revenue Act of 1928. And so it has remained under all subsequent Acts, viz, Section 114 (b) (3), Internal Revenue Code. But the statutory term "gross income from the property" needed interpretation and the Treasury Regulations undertook this interpretation and the necessary implementation of the statutory provisions. Articles 221 and 1602, Treasury Regulations 69, promulgated under the Revenue Act of 1926, throw little light upon the subject, but Article 201, dealing with depletion of mines as well as of oil and gas wells, concluded by saying that if the raw mineral product were manufactured or converted into a refined product "then the gross income shall be assumed to be equivalent to the market or field price of the raw material before conversion." Article 221, Treasury Regulations 74, promulgated under the Revenue Act of 1928, was slightly more detailed and read in pertinent part:

> If the oil and gas are not sold on the property but *are manufactured or converted into a refined product* or are transported from the prop-

[6] See, also, the same report, p. 30 (1939–1 Cum. Bull. (Part 2) 518), and the conference report, H. Conference Rep. No. 1492, 72d Cong., 1st Sess., p. 14 (1939–1 Cum. Bull. Part 2) 539, 542).

> erty prior to sale, then the gross income [from the property] shall be assumed to be equivalent to the market or field price of the oil and gas *before conversion* or transportation." [Italic ours.]

This regulation, of course, was a proper implementation of the statute, and its validity is not now open to doubt. *Brea Cannon Oil Co.* v. *Commissioner,* 77 F. 2d 67 (C. C. A. 9th), certiorari denied, 296 U. S. 604; *Consumers Natural Gas Co.* v. *Commissioner,* 78 F. 2d 161 (C. C. A. 2d), certiorari denied, 296 U. S. 634; *Greensboro Gas Co.* v. *Commissioner,* 79 F. 2d 701 (C. C. A. 3d), certiorari denied, 296 U. S. 639.

Thus in *Brea Cannon Oil Co.* v. *Commissioner, supra,* the case of a taxpayer who processed its own wet gas at its wells to extract dry gas and casing-head gasoline, this Court said (p. 69) that the provision for percentage depletion in the Revenue Acts of 1926 and 1928 "is intended to represent the amount of capital recovered in the product produced by the well, that is *the value of the raw product.*" [Italics ours.] And, somewhat similarly, in *Consumers Natural Gas Co.* v. *Commissioner, supra,* where the precise problem was to determine the "gross income from" oil and gas wells which under the Revenue Acts of 1926 and 1928 was subject to percentage depletion, the court said (pp. 161–162).

> * * * we are not justified in injecting into the "basis" ["the gross income from the property"] the added value imparted to the output by work done upon it after it reaches the surface.

See also, *United States* v. *Ludey,* 274 U. S. 295, 302, When Congress, by the Revenue Act of 1932, "extended" percentage depletion to metal mines it did so in the light of the legislative and administrative experience with percentage depletion in the case of oil and gas wells. The rate of percentage depletion for oil and gas wells was $27\frac{1}{2}$ per cent "of the gross income from the property" during the taxable year;[7] the rate for metal mines was "15 per centum * * * of the gross income from the property during the taxable year." Section 114 (b) (4), Revenue Acts of 1932, 1934, c. 277, 48 Stat. 680, 1936, c. 690, 49 Stat. 1648, 1938, c. 289, 52 Stat. 447, and the International Revenue Code (Appendix, *infra*). Treasury Regulations were forthwith promulgated to implement the new statutory provisions, and they, as might be expected, followed the pattern established by Regulations 69 and 74 for determining "gross income from the property" in the case of oil and gas wells. Ore mining, no less than the production of crude oil from oil wells or wet gas from gas wells, yields a raw product at the earth's surface. This must be processed and refined, quite often by very elaborate methods, to secure *an ultimate product* usable in industry. These processes, like the "cracking" and other methods employed in the distillation of gasoline or the methods used in the separation of wet gas into dry gas and casinghead gasoline, the Treasury Department and its experts, including engineers, believed were essentially manufacturing and not mining operations and processes. The Treasury Department, bearing in mind that the purpose of the

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[7] Section 204 (c) (2), Revenue Act of 1926; Section 114 (b) (3), Revenue Act of 1928.

statutory allowances for depletion, both with respect to mineral mines and with respect to oil and gas wells, is to allow a tax-free return of capital invested in minerals in place, i. e., of "the value of the raw product" (*Brea Cannon Oil Co.* v. *Commissioner, supra,* p. 69),[8] promulgated its Regulations accordingly.

From the first these Regulations said plainly that "gross income from the property", as used in Section 114 (b) (3) *and* (4) of the statute and in the implementing articles of the Treasury Regulations, *meant* the selling price of *"the crude mineral product"* of the mineral property or, *if* the crude product were not sold as such but was processed, the field price *"before the application of any processes* (to which the crude mineral product may have been subjected after emerging from the mine or well)" with the exception of certain processes specifically listed. Article 22 (*g*), Treasury Regulations 77, promulgated under the Revenue Act of 1932 (Italics ours). The same excepted processes were allowed if there was no representative field price for the taxpayer's crude mineral product, so that the taxpayer had to process or refine his raw product to obtain a marketable product. When such was the situation a fair market or field price *for the crude mineral product* was to be calculated.

This was not difficult. The field price of the first marketable product after processing was taken as the base and from that deductions were directed to get the value of the raw mineral product before processing (and hence the amount of the ultimate gross income

[8] Cf. *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364; *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362, 366–368; *Consumers Natural Gas Co.* v. *Commissioner supra*, pp. 161–162.

received for the minerals). From the first the Regulations [9] directed the deduction, from the basis, of all processing costs after mining (including transportation) save that as a rather generous concession to mine owners certain processing costs were excepted by the Regulations. The cost of the excepted processes need not be deducted in a mine owner's calculations to determine his "gross income from property", i.e., his gross income from the raw mineral product, for depletion purposes. Then the Treasury Department realized that the entire net profit which a mine operator-processor realized from selling refined or manufactured products was not necessarily a result of just the mining operations, but was the result of *the sum of* the mining and the further processing, refining and manufacturing operations.

Article 23 (m)–1 of Treasury Regulations 101, promulgated under the Revenue Act of 1938, was amended accordingly by T. D. 4960, 1940–1 Cum. Bull. 38, 39, promulgated January 3, 1940, to exclude from the determined "gross income from" the raw mineral product the proportionate profits attributable to the refining and manufacturing operations, and Section 19.23 (m)–1 of the Regulations under the Internal Revenue Code, Treasury Regulations 103, promulgated January 29, 1940, contains the same provision.

[9] Article 221, Treasury Regulations 77; also, Article 23 (m)–1, Treasury Regulations 86, promulgated under the Revenue Act of 1934, Treasury Regulations 94, promulgated under the Revenue Act of 1936, Treasury Regulations 101, promulgated under the Revenue Act of 1938, and Section 19.23 (m)–1, Treasury Regulations 103, promulgated under the Internal Revenue Code (Appendix, *infra*).

Otherwise those Regulations are precisely the same as the three immediately preceding Regulations. Thus to calculate a fair field price for the raw mineral product, where it could not be sold in its crude state, the mine owner-processor must—under Treasury Regulations 101, as amended, and Treasury Regulations 103—deduct from the field price of the first marketable product after processing "the costs *and proportionate profits* attributable to the transportation and the processes not listed below."[10] [Italics ours.] The processes, the cost of which need not be thus deducted, are as follows:[11]

> (4) In the case of lead, zinc, copper, gold, or silver ores and ores which are not customarily sold in the form of the crude mineral product—crushing, concentrating (by gravity or flotation), and other processes to the extent to which they do not beneficiate the product in greater degree (in relation to the crude mineral product on the one hand and the refined product on the other) than crushing and concentrating (by gravity or flotation).

The Tax Court has approved the determination of the "gross income [of each of the several taxpayers] from" its raw mineral product, i. e., its cinnabar ore, in accordance with these Regulations. Only the New Idria Quicksilver Mining Company is substantially concerned with the effect of the Commissioner's

[10] This phrase of Treasury Regulations 101 before its amendment read: "* * * the cost (including transportation costs) of the processes not listed below."

[11] Subparagraph (g) (4) is precisely the same under all the Treasury Regulations, 77, 86, 94, 101 and 103.

amendment to Treasury Regulations 101 by T. D. 4960, January 3, 1940, and that company only so far as that amendment affects its taxable year 1939; the case of each of the other taxpayers involves only its tax year 1940, as to which no claim can be made that the amended regulation is retroactive. We shall, therefore, seek first to dispose of the argument of the several taxpayers that the entire sales price of their refined mercury represented their "gross income from" the raw cinnabar which they mined, and then disposed of New Idria's incidental argument that the Commissioner's amendment of Article 23 (m)–1, Treasury Regulation 101, by T. D. 4960, on January 3, 1940, was retroactive, so far as concerns New Idria's tax year 1939, and invalid.

(a) In the face of the legislative history detailed above we think it impossible for anyone to maintain that, by the "extension" of percentage depletion to metal mines, Congress intended to authorize depletion upon the enhanced sale price of an ultimate product which is the result of applying—to the raw mineral product brought out of the mine—non-excepted processes, whether refining, manufacturing, or otherwise. The fundamental purpose of a depletion deduction was a compensatory allowance to owners, on account of severance of their natural resource when consumed in the production of income, and this is just as true where the statute allows a deduction based on "gross income from the property" as where the depletion is based on cost or on discovery value. *Helvering* v. *Bankline Oil Co., supra,* pp. 366–367; *Anderson* v. *Helvering,* 310 U. S. 404, 407–408; *Brea Cannon Oil*

Co. v. *Commissioner, supra.* Cf. *United States* v. *Ludey, supra.*

Ordinarily a market price exists for the raw mineral product as it is produced. Where this is so the "gross income from the property" is the sale price of *the crude mineral* product in the immediate vicinity of the mine or well. One subject of the Regulations is the determination of an equivalent of such fair market price for the raw product in instances where elaborate processing of the crude mineral is necessary to get a marketable product.

The price which a mine operator-refiner or manufacturer eventually received for an ultimate product (after the application of elaborate non-excepted processes to the crude mineral) is obviously a price not for his crude mineral as such but *for a crude mineral plus,* in short, for the mineral *as refined and beneficiated* by the further processes. The intermediate processes are plainly manufacturing (and not mining) processes.[12] Thus logically and properly the Regulations from the very first specified (see fn. 9, *supra*) that the "gross income from the [raw mineral] property" could not include what was in reality paid or received for the processing beyond a certain initial state for the refining or for the manufacturing of a taxpayer's ore into something else. In this instance it happens to be liquid mercury. This, we submit, was a perfectly valid regulatory rule carrying out

[12] In *Brea Cannon Oil Co.* v. *Commissioner*, *supra*, p. 68, this was conceded. See, also, *Helvering* v. *Bankline Oil Co.*, *supra*, pp. 365, 367–369, where, as here, the particular taxpayer had to process in order to get a salable commodity.

the intent of the statute. *Brea Cannon Oil Co.* v. *Commissioner, supra; Consumers Natural Gas Co.* v. *Commissioner, supra; Greensboro Gas Co.* v. *Commissioner, supra.* See, too, *Helvering* v. *Wilshire Oil Co.,* 308 U. S. 90, 102. Moreover, the several successive subsequent reenactments of the same statutory provisions for percentage depletion in the case of mines constitutes the strongest possible evidence that Congress approved the regulation as a proper interpretation of the statute. Cf. *Helvering* v. *Winmill,* 305 U. S. 79, 82–83; *Murphy Oil Co.* v. *Burnet,* 287 U. S. 299, 302–303.

(b) For several reasons the exchange of views among a few Senators on the floor of the United States Senate during the debate on the Revenue Act of 1942 cited in taxpayer's brief (pp. 27–30) is without significance in the present litigation. First, in construing a statute recourse is permissible to Congressional debates, in order to ascertain the intent of Congress, only where there was a contemporaneous exposition of the particular legislative provisions on the floor of Congress.[13] Thus the views expressed by two or three Senators in 1942 as to their understanding of the purpose and meaning of statutory provisions passed in 1932, and reenacted in 1934, 1936, 1938 and as a part of the Internal Revenue Code in 1939, are unimportant. The views may be expressed in the utmost good faith, but still they are unimportant under the safeguarding rule just mentioned. Moreover, the particu-

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[13] The cases which taxpayers cite (Br. 30–31) all support this principle, and not the principle for which they are cited.

lar senatorial statements quoted in taxpayer's brief are in part self-contradictory, in part are statements of hearsay, and the part most emphasized in taxpayer's brief (p. 29) represents the particular Senator's personal deduction or conclusion, which notably is in substantial contradiction to what he said he had been told.[14] If Congress chooses to amend the statute, prospectively or retroactively, to provide that the depletion allowance in the case of the mining of quicksilver ores shall not be based upon the value of the crude cinnabar ore when extracted from the mine but upon the sale price of the ultimate product *as enhanced* by furnacing and refining operations applied to the ores, that would be a quite different matter, and one, of course, within the province of Congress to limit, deny, condition or grant deductions as it deems proper.

(c) The facts of these cases plainly bring the several taxpayers within the terms of the Regulations. Taxpayers did not crush the cinnabar ore and concentrate

[14] It was the Senator's own conclusion (Pet. Br. 29) as to how the furnacing of quicksilver ores must be treated under the Regulations. Actually there is and has been no variance, as taxpayers suggest (Pet. Br. 31), between the position of the Commissioner and the position of the General Counsel for the Treasury on the matter: That the gross income of a taxpayer from mining cinnabar ore must be determined, in accordance with the Treasury Regulations, by excluding from the price received for his refined product, i. e., liquid mercury, his furnacing, cleaning, flasking and transportation costs and the part of his total profits on his combined mining, refining and transportation operations which is in proportion to such furnacing and other refining and transportation costs.

it by gravity or flotation, and they make no pretense that they did.[15] They used other processes, but by them they beneficiated the crude mineral product in a very much greater degree than if they had merely crushed and concentrated the cinnabar by gravity or by flotation and the Tax Court upon ample evidence [16] properly so found. (R. 100–101.) Its finding on this aspect of the case, therefore, seems unassailable. *Dobson* v. *Commissioner* (Sup. Ct.), decided December 20, 1943 (1943 P-H, par. 62,029); *Wilmington Trust Co.* v. *Commissioner,* 316 U. S. 164; *Helvering* v. *Nat. Grocery Co.,* 304 U. S. 282, 295.

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[15] Concentration (whether of quicksilver bearing or of other ores) by gravity or by flotation is a purely mechanical process and does not involve the application of heat. (R. 68, 100–101.) It is physically and technically possible to concentrate cinnabar by gravity or by flotation but it is uneconomical, and none of the taxpayers concentrated cinnabar by either of such methods during the tax years. (R. 100; see, also, R. 65, 66–67.) New Idria's predecessors in title did concentrate cinnabar for a time, but this operation was stopped before the tax years when modern furnaces for roasting cinnabar ore were installed. (R. 86.)

[16] The recovery by roasting the cinnabar ore in taxpayers' revolving furnaces and in concentrating and distilling the gases is always better than 97 per cent of the quicksilver in the ores, whereas but only 60 to 80 per cent of the quicksilver in the cinnabar ore is recovered if the cinnabar is first concentrated by gravity or flotation. (R. 81.) Moreover, mere concentration effects no chemical change in the cinnabar ore (R. 67–68), for the concentrated ore must still be retorted and further processed (R. 72, 76, 93–94). Upon the other hand, when cinnabar ore is put through taxpayers' revolving furnace process its chemical composition changes and practically pure mercury or quicksilver results from the condensation and distillation of the gases liberated in the roasting process. (R. 68, 71, 77.)

In such circumstances the regulation applies and, being valid as we have already seen, it controls. Thus, under the Regulations a mine owner's gross income from his crude mineral product does not include the part of the sale price of his ultimate refined or manufactured product attributable to transportation, or to refining and manufacturing processes and the profit realized on them, or, more precisely, to the part of the sale price of his ultimate product which is attributable to any process after extraction of the crude mineral product from the earth (save crushing and concentrating by gravity or flotation), which beneficiates that product in greater degree (in relation to its crude state on the one hand and the refined product on the other) than crushing and concentrating by gravity or flotation.

(d) The amendment (see fn. 10, *supra*) to Article 23 (m)–1, Treasury Regulations 101, by T. D. 4960, 1940–1 Cum. Bull. 38, 39, promulgated January 3, 1940, was the result of the Treasury Department's realization that the Regulations as written might seem to give the operator-processor of certain kinds of mineral mines an advantage to which he was not entitled. Where the operator-processor sells his ultimate product at an over-all profit, that profit is not necessarily a result of just his mining operations, but is the result of *the sum of* his mining, further processing, refining and manufacturing operations, including transportation.

Congress had allowed mine operators a depletion allowance in the case of mineral mines of 15 per cent of "gross income from the property" being depleted, i. e., of gross income from *the crude ore.* This would seem to exclude a deduction of a percentage of gross income from other sources. Cf. *Brea Cannon Oil Co.* v. *Commissioner, supra,* p. 69; *Consumers Natural Gas Co.* v. *Commissioner, supra,* pp. 161–162; *Helvering* v. *Bankline Oil Co., supra.* Where the combined or consecutive operations (of mining and refining or other nonexcepted processing) are conducted at an over-all net profit, a taxpayer's gross income from such non-mining operations is something different from the mere cost of such operations. The over-all net profit has its source, in part, in such other operations, and in part presumably is a profit on those operations.[17]

For that reason Article 23 (m)–1 (g) of Treasury Regulations 101 was amended (and renumbered as (f)) to make it very certain and clear that the depletion permitted is on "the gross income from" the crude mineral and not on the gross income from nonexcepted processing, viz, refining, manufacturing and so forth, to which a taxpayer's crude mineral may be subjected upon being mined. Thus taxpayers were advised that they could not claim a depletion deduction upon either their gross income from nonexcepted processing, refining or manufacturing of extracted

[17] These other operations require capital investment and management functions just as much as the investment in the mine and mining equipment. Obviously the operator of a quicksilver or cinnabar ore mine should expect a return on his investment in the furnacing, condensing and other equipment just as much as a return on his investment in the ores in place.

minerals or upon their net profits from such sources. This certainly was a correct statement of the rule prescribed by statute that the percentage depletion should be a stated percentage of the "gross income from" the property, i. e., the crude mineral product. As such, it was valid whether made effective prospectively only or also retroactively. Cf. *Murphy Oil Co.* v. *Burnet, supra,* pp. 303–304, 306–307, where a Treasury Regulation, as amended by a Treasury Decision on November 13, 1926, was held to determine the amount of depletion allowable to a taxpayer for the tax years 1919 and 1920. See, also, *Manhattan Co.* v. *Commissioner,* 297 U. S. 129, 135; *Morrissey* v. *Commissioner,* 296 U. S. 344, 355. Obviously the amendment to the regulation, Article 23 (m)–1 (g), Treasury Regulations 101, was effective for the tax year in which it occurred and subsequent years. *Helvering* v. *Wilshire Oil Co., supra; Helvering* v. *Reynolds,* 313 U. S. 428. As previously mentioned, only New Idria Quicksilver Mining Company is concerned with the question whether the amendment was effective as to the tax year 1939. That it was we submit is clear under the principle of the *Murphy Oil Co.* case and the other cases cited therewith, *supra.*

(e) We quite agree with taxpayers' thesis (Br. 21–24) that the Commissioner cannot promulgate Regulations inconsistent with the statute. He has not done so here. On the contrary, and as we have already pointed out, the Commissioner's Regulations which are involved here only carry into effect the will of Congress as expressed by the statute, namely, that persons engaged in metal mining shall receive, if they elect it, a depletion allowance of 15 per centum of their "gross income from" their crude mineral resource. That is all the statute authorizes. That is all they are entitled to get. They cannot increase their depletion allowance by doing other things to their product, viz, refining it, after they mine it.

Only *Helvering* v. *Mountain Producers Corp.*, 303 U. S. 376, out of the remaining cases cited in sections (1) to (4) of taxpayers' brief needs further comment. The facts there were as follows: A refining company had entered into a contract with Wyoming, a subsidiary of Mountain Producers, to drill Wyoming's leaseholds and operate any producing wells without cost to Wyoming and to purchase the oil from the properties under an agreed price scale. The Commissioner allowed Wyoming percentage depletion upon the cash payments it received from the refining company under the contract. The taxpayer and Wyoming insisted that the latter's "gross income from the property", subject to percentage depletion, was what the refining company paid Wyoming under the contract *plus* the cost of production defrayed by the refining company. The Supreme Court sustained the Commissioner. Somewhat similarly here these taxpayers, who did their own mining and then put their crude cinnabar ore through elaborate subsequent processes (furnacing, drawing off the gases, condensing them and cleaning and flasking the product) are not entitled to treat as gross income from their crude mineral what in reality they received from the furnacing and other processing and the profit apportionable to such post-mining operations.

The Supreme Court, it may be noted, decided *Helvering* v. *Mountain Producers Corp., supra,* on the same day as *Helvering* v. *Bankline Oil Co., supra,* already cited in this brief. The *Bankline* decision plainly supports the Tax Court's conclusion on the present issue in these cases, for in the *Bankline* case the Supreme Court held that the treatment of the raw product of an oil well to secure a commercially marketable product was *a processing* and not a mining operation *and that percentage depletion was not allowable to a processor upon his gross processing income.*

II

The New Idria Quicksilver Mining Company was not entitled to percentage depletion in respect to its gross income from the "dump" material which others had dumped upon the land

As a more or less incidental operation the New Idria Quicksilver Mining Company processed some of the previously untreated cinnabar ore and some of the ore already treated by previous owners which New Idria found in great piles or dumps upon its land when it acquired the land in 1936. The dump ore had been mined from the land which New Idria bought by New Idria's predecessors in title to that land and deposited there and remained in such dumps until New Idria removed and furnaced and treated it for its mercury content during the tax years. (R. 29, 31–34.) The Commissioner argued before the Tax Court that New Idria was not entitled to a deduction for depletion in respect to its gross income from the dump ores, and the Tax Court sustained the contention, holding, in short, that the gross income New Idria received from or for dump ores was not income from the operation of its mine and, therefore, was not a depletable interest. (See R. 106.) This conclusion seems correct.

We grant that if New Idria had mined the cinnabar ore and treated it insufficiently at the time or not treated it at all, but subsequently put it through its mills, it would have been entitled to percentage depletion in respect to its gross income from the crude mineral. *Commissioner* v. *Kennedy Min. & M. Co.*, 125 F. 2d 399 (C. C. A. 9th). But that is not what occurred. Others mined the ore and deposited it before New Idria even came into existence.[18] New Idria merely acquired the dumps along with the land upon which they were located. The dump material was not a part of any mine when New Idria bought it or thereafter. If depletion is restricted, as the cases indicate, to a person having an economic interest in the crude minerals in place in the earth on account of the mining or removal of such ores, it would seem that New Idria was not entitled to a deduction for depletion when it undertook to move, crush, and screen the dump ore preliminary to furnacing and otherwise processing and refining it.[19] New Idria's entire activities with respect

[18] New Idria was organized July 3, 1936. (R. 28.)

[19] In any event and for precisely the reasons set forth in section I of this Argument, New Idria Quicksilver Mining Company was not entitled to depletion on its gross income *from roasting and otherwise processing* the crude dump ores into refined and marketable liquid mercury, those being non-excepted processing, refining or manufacturing operations.

to the dump material would seem much more nearly akin to those of the processor in *Helvering* v. *Bankline Oil Co.,* 303 U. S. 362, 368, who, the Supreme Court held, had no right whatever to a deduction for depletion. See, also, *Consolidated G. & S. M. Co.* v. *Commissioner,* 133 F. 2d 440 (C. C. A. 9th); *Atlas Milling Co.* v. *Jones,* 115 F. 2d 61 (C. C. A. 10th), certiorari denied, 312 U. S. 686. Cf. *Texas Pipe Line Co.* v. *Commissioner,* 88 F. 2d 278 (C. C. A. 3d), certiorari denied, 302 U. S. 706.[20]

III

Oat Hill Mine Inc., is not entitled to a deduction from its income for any part of the $3,750 it paid to an electric company during the tax year 1940 for an extension of a power line to the Oat Hill Mine

Oat Hill Mine, Inc., did not pay the $3,750 to Pacific Gas & Electric Company for current service of any character or as an advance payment for future service. It paid the $3,750 to secure the extension of a transmission line to its property. We do not know the expected useful life of such facilities, and in any event they belong to Pacific Gas & Electric Company under the contract between the parties. (R. 59.) Moreover, Oat Hill's contract with Pacific provided that—after 36 consecutive months of use if Oat Hill's business had

[20] Cf. also, *So. Utah Mines* v. *Beaver County,* 262 U. S. 325, holding copper tailings, all of which apparently were the residue of ore removed from the mining claims of Utah Mines or of its predecessor in title, deposited in dumps near the concentration mill which seems to have been on a separate mining claim belonging to Utah Mines, *did not constitute a mine* taxable as such under the laws of the State of Utah.

at that time proved its permanency to the electric company's satisfaction—the latter should "repay" to Oat Hill the $3,750 it had paid to induce the construction, save for a portion which would itself thereafter be refunded in accordance with the company's practice. (R. 60.)

A witness for Oat Hill testified (R. 84) that at the time Oat Hill made its payment he thought the mining operations at the Oat Hill property would last "as long as the war," in which we were not yet engaged, and which, the witness speculated, "might have been three years, possibly less."

Obviously no part of the $3,750 deposit may be deducted by Oat Hill from its year 1940 income. The full deposit probably has been repaid to Oat Hill before this. But even assuming, *arguendo,* that Oat Hill may never get the $3,750 back, the money so paid, as the Tax Court noted (R. 107–108), was in the nature of a capital investment within the principle of *Duffy* v. *Central R. R.,* 268 U. S. 55,[21] and the period of service which the deposit made possible was "an indefinite period" (R. 108). This would not support a deduction for depreciation or exhaustion of the investment over any period. Cf. *Clark Thread Co.* v. *Commissioner,* 100 F. 2d 257, 258 (C. C. A. 3d). The ideas of Oat Hill's witness as to how long the war and the cinnabar mining operations at Oat Hill would last were, of course, too speculative and indefinite to support any deduction allowance, and the Tax Court

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[21] Cf. *Weiss* v. *Wiener,* 279 U. S. 333; *Murphy Oil Co.* v. *Burnet,* 55 F. 2d 17, 25–26 (C. C. A. 9th).

properly so held. (R. 109.) Thus, for two reasons, each of them sufficient, no part of the $3,750 payment may be deducted from Oat Hill's gross income for the year 1940: First, the payment was refundable; and, second, even if never refunded it was a capital investment to induce service for "an indefinite period."

CONCLUSION

The decision of the Tax Court was correct upon each of the several issues raised by these appeals and its decision, in each of the several cases, should accordingly be affirmed.

Respectfully submitted.

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February 1944.

APPENDIX

Internal Revenue Code:[1]

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—

(1) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * * and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance

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[1] The provisions of the Revenue Act of 1938, c. 289, 52 Stat. 447, of pertinence only to the case of the New Idria Quicksilver Mining Company for its fiscal years 1938 and 1939, are similar to the correspondingly numbered provisions of the Internal Revenue Code and hence are not quoted here.

under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

*   *   *   *   *

(26 U. S. C. 1940 ed., Sec. 23.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; * * *

*   *   *   *   *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

*   *   *   *   *

(26 U. S. C. 1940 ed., Sec. 113.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

(b) *Basis for Depletion.*—

(1) *General Rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * * * *

(4) *Percentage Depletion for Coal and Metal Mines and Sulphur.*—The allowance for depletion under section 23 (m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property. * * *

(26 U. S. C. 1940 ed., Sec. 114.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

Sec. 19.23 (m)–1. *Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.*—Section 23 (m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section

114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.

*   *   *   *   *

When used in these sections (19.23 (m)–1 to 19.23 (m)–28, inclusive) covering depletion and depreciation—

*   *   *   *   *

(*b*) A "mineral property" is the mineral deposit, the development and plant necessary for its extraction, and so much of the surface of the land only as is necessary for purposes of mineral extraction. The value of a mineral property is the combined value of its component parts.

(*c*) The term "mineral deposit" refers to minerals in place. The cost of a mineral deposit is that proportion of the total cost of the mineral property which the value of the deposit bears to the value of the property at the time of its purchase.

* * * * *

(*f*) "Gross income from property," as used in section 114 (b) (3) and (4) and sections 19.23 (m)-1 to 19.23 (m)-28, inclusive, means the amount for which the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine or well, but, if the product is transported or processed (other than by the processes excepted below) before sale, it means the representative market or field price (as of the date of sale) of crude mineral product of like kind and grade before such transportation or processing. If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation and the processes not listed below. The processes excepted are as follows:

(1) In the case of coal—cleaning, breaking, sizing, and loading at the mine for shipment;

(2) In the case of sulphur—pumping to vats, cooling, breaking, and loading at the mine for shipment;

(3) In the case of iron ore and ores which are customarily sold in the form of the crude mineral product—sorting or concentrating to bring to shipping grade, and loading at the mine for shipment; and

(4) In the case of lead, zinc, copper, gold, or silver ores and ores which are not customarily sold in the form of the crude mineral product—crushing, concentrating (by gravity or flotation), and other processes to the extent to which they do not beneficiate the product in greater

degree (in relation to the crude mineral product on the one hand and the refined product on the other) than crushing and concentrating (by gravity or flotation).

In case any of the excepted processes are not applied in the immediate vicinity of the mining district in which the mine is located, costs incurred for transportation to the processing location and, if transported by taxpayer, the proportionate profits attributable to transportation should be subtracted from the sale price of the product to determine "gross income from the property."

In the case of oil and gas, if the crude mineral product is not sold on the property but is manufactured or converted into a refined product or is transported from the property prior to the sale, then the "gross income from the property" shall be assumed to be equivalent to the market or field price of the oil or gas before conversion or transportation.

* * * * *

(*g*) "Net income of the taxpayer (computed without allowance for depletion) from the property," as used in section 114 (b) (2), (3), and (4) and sections 19.23 (m)–1 to 19.23 (m)–28, inclusive, means the "gross income from the property" as defined in paragraph (*f*) of this section less the allowable deductions attributable to the mineral property upon which the depletion is claimed and the allowable deductions attributable to the processes listed in paragraph (*f*) in so far as they relate to the product of such property, including overhead and operating expenses, development costs properly charged to expense, depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. Deductions not directly attributable to particular properties or processes shall be fairly allocated. To illustrate: In cases where the taxpayer engages in activities in addition to mineral extraction and to the processes listed in paragraph (*f*), deductions for depreciation, taxes, general expenses, and overhead, which cannot be directly attributed to any specific activity, shall be fairly apportioned between (1) the mineral extraction and the processes listed in paragraph (*f*) and (2) the additional activities, taking into account the ratio which the operating expenses directly attributable to the mineral extraction and the processes listed in paragraph (*f*) bear to the operating expenses directly attributable to the additional activities. If more than one mineral property is involved, the deductions apportioned to the mineral extraction and the processes listed in paragraph (*f*) shall, in turn, be fairly apportioned to the several properties, taking into account their relative production.

(*h*) "Crude mineral product," as used in paragraph (*f*) of this section, means the product in the form in which it emerges from the mine or well.

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